Docket Nos. 01-0705,
02-0067 & 02-0725
ICC Staff Exhibit 4.0

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission on its own motion Northern Illinois Gas Company d/b/a NICOR Gas Company Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs prudently incurred	)	Docket No. 01-0705
Illinois Commerce Commission on its own motion Northern Illinois Gas Company d/b/a NICOR Gas Company Proceeding to review Rider 4, Gas Cost, pursuant to Section 9-244(c) of the Public Utilities Act	)	Docket No. 02-0067
Illinois Commerce Commission on its own motion Northern Illinois Gas Company d/b/a NICOR Gas Company Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs prudently incurred	)	Docket No. 02-0725

DIRECT TESTIMONY ON REOPENING

OF

STEVEN R. KNEPLER

Accounting Department

Financial Analysis Division

Illinois Commerce Commission

AUGUST 14, 2009

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WITNESS IDENTIFICATION

Q. Please state your name and business address.

A. My name is Steven R. Knepler. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. By whom are you employed and in what capacity?

A. I am currently employed as a Supervisor in the Accounting Department of the Financial Analysis Division, Illinois Commerce Commission ("ICC" or "Commission").

Q. Please describe your background and professional affiliations.

A. I hold a Bachelor of Science Degree in Accounting from Illinois State University. I am a Certified Public Accountant, licensed to practice in the State of Illinois. I joined the Commission's staff ("Staff") in January 1982. Prior to joining Staff, I was employed as an auditor for other State agencies.

Q. Have you previously testified before any regulatory body?

A. Yes, I have testified on several occasions before the Commission.

Q. Have you previously filed testimony in this proceeding?

A. Yes. My original direct testimony on reopening was filed on the Commission's e-docket system on November 23, 2003 as ICC Staff Exhibit 4.00 and my rebuttal testimony on reopening was filed on February 27, 2004 as ICC Staff Exhibit 8.0. Although those documents remain on the Commission's e-docket system, they were never entered into evidence. Nicor withdrew its testimony on reopening that it had previously filed in the reopening and refiled its direct testimony on April 13, 2007. Pursuant to the ALJs' (Administrative Law Judges') notice of May 8, 2009, this testimony is intended to respond to Nicor's April 13, 2007 direct testimony on reopening.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to address Northern Illinois Gas Company's ("Nicor" or "Company") accounting and PGA treatment of the 2% adjustment factor applied to volumes of gas withdrawn from Company owned aquifer storage fields. Staff witness Zuraski has quantified and is sponsoring the adjustment to correct withdrawals from the Company owned aquifer storage fields; I am offering testimony to support his adjustment.

ADJUSTMENT TO CORRECT THE ACCOUNTING FOR THE COST OF GAS WITHDRAWN

Q. How does Nicor determine the cost of gas withdrawn from Company owned aquifer storage fields?

A. For each of its eight aquifer storage fields, Nicor measures the amount of gas physically withdrawn as determined by meter readings.[1] These metered amounts were then increased by a 2% factor and the resulting totals were then reported to Nicor's Accounting Department as representing the storage withdrawals for the month. Nicor's Accounting Department then assigned a cost to these withdrawal volumes using the LIFO method[2]; transferred the resulting cost from a storage account to a gas cost account; and ultimately charged these costs to customers through the PGA. For example, if Nicor physically withdrew 100 units of gas from storage, customers were charged for 102 units of gas.

Q. Do you agree with Nicor's procedures used to determine the cost of gas withdrawn?

A. No. Nicor is charging its customers for 102 units of gas when only 100 have actually been withdrawn. I disagree with Nicor's procedure because it violates the Commission's PGA rule (83 Ill. Adm. Code 525) and the system of accounts (83 Ill. Adm. Code 505).

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[1] Nicor monthly "Storage Injections & Withdrawals" report.
[2] LIFO, last in first out method of assigning costs to inventory.

Q. What does the 2% withdrawal factor represent?

A. The 2% withdrawal factor represents gas that has been injected into storage and becomes unavailable under normal operations for withdrawals because it was used to maintain pressure or it is used in the operation of the storage field. In the summary response to Staff Data Requests ENG-1.1 to ENG-1.6, Nicor states, in part:

> This adjustment of 2% volume is comprised of both (1) un-metered gas used in the storage process of injecting, withdrawing, and operating storage reservoirs and (2) replenishment of gas volumes that have become non-effective in contributing to the performance of the storage reservoir. These storage processes include, but are not limited to:
>
> - Well head catalytic heating
> - Compressor blowdowns
> - Well logging
> - Tie-ins
> - Process control operation

Q. How did Nicor determine the 2% factor?

A. That information was not included in Nicor's responses to Staff Data Requests ENG-1.1 to ENG-1.6. Therefore, I cannot opine about the appropriateness of the 2% factor because I do not know if it is an arbitrary adjustment or if it is based upon a study. However, regardless of the reasoning, it is an improper procedure for the reasons discussed below. The Company should not be allowed to charge ratepayers through the PGA for gas that has neither been withdrawn from storage nor consumed by the customer.

Q. Does the 2% adjustment added to metered withdrawals represent gas physically withdrawn from storage?

A. No, it represents the gas that remains in the storage field as cushion gas or was used in the operation of the field.

Q. Is the cost of gas injected into storage but not available for withdrawal in the normal operation of the gas reservoir a PGA recoverable gas cost in accordance with 83 Ill. Adm. Code 525 (the Commission's PGA rule)?

A. No. Storage gas is not chargeable to customers through the PGA until it is withdrawn and made available for consumption. According to 83 Ill. Adm. Code 525, the Commission's PGA rule:

> **The cost of gas estimated to be withdrawn from storage during the base period shall be included in the gas charge. (83 Ill. Adm. Code 525.40(c)).**

The cost of gas that I am disallowing (the 2% adjustment) was not withdrawn from storage during the reconciliation years. In order to maintain the operational pressure of the storage fields[3], Nicor injects a certain volume of gas that is not withdrawn for customer use, but remains within the storage field indefinitely or is used in the operation of the field.

Q. Please describe how gas cost is properly accounted for when the gas utility has underground storage facilities in order to be in compliance with 83 Ill. Adm. Code 505 (the USOA for gas utilities).

A. Initially, the cost of gas bought by a utility is charged to the purchased gas expense account. However, if portions of these purchases are transferred (injected) into the storage field, there will be an accounting adjustment to reduce the purchased gas expense account to recognize this transfer. The accounting sequence is to credit (or decrease) the purchased gas expense account and charge (debit or increase) the gas stored underground account (commonly referred to as working gas) for the cost of gas injected into storage. After this adjustment to reflect the transfer of gas into the storage field, only the cost of gas actually delivered to the customer remains in the purchased gas expense account. The cost of gas in the purchased gas expense account is the amount charged to the customer through the PGA. When the gas is ultimately withdrawn from the underground storage for customer use, the accounting sequence is reversed. The cost of the gas withdrawn will be credited (decreased) from the gas stored underground account and charged back (increased) to the purchase

[3] Nicor Response to Staff Data Request ENG 1.1 – ENG 1.06 (Response Date November 5, 2003).

gas expense account. Thus, the customer is not charged until the gas is actually withdrawn and consumed.

Q. Explain how Nicor's accounting for gas withdrawn from underground storage deviates from the appropriate accounting previously described.

A. Accounting should be an accurate representation of the events that have actually happened. In the case of storage gas, four separate and distinct events have taken place:

1. Gas has been purchased;
2. Gas has been injected into the storage field;
3. Gas has been withdrawn for customer consumption; and
4. A portion of the gas injected into the storage field remains in storage as cushion gas or was used in the operation of the field. This is the gas represented by the 2% adjustment.

It is event number 4 that Nicor has failed to account for properly. Nicor has incorrectly included this gas with the actual withdrawals reported to Accounting. Thus, Nicor has removed the cost from storage and charged it to gas cost that will be recovered through the PGA. This accounting treatment is not an accurate representation of what actually happened. Instead, it gives the erroneous impression that this additional 2% of gas was actually withdrawn from storage. More importantly, this accounting treatment is inconsistent with PGA rules by including the cost of gas that was not withdrawn. Nicor's non-recoverable cushion gas should instead be recovered through base rates while its recoverable cushion gas should be recovered through the PGA when it is withdrawn, an event which has not taken place.

Q. How should Nicor account for the gas related to the 2% adjustment factor?

A. When gas is initially injected into storage, it is classified as working gas (or top gas). If a portion of this injected gas becomes unavailable for withdrawal, it should be reclassified to cushion gas – either recoverable or nonrecoverable, or charged to underground storage expense.[4] The cost of recoverable cushion gas (Account 117, Gas Stored Underground-Noncurrent) remains in storage until it is actually withdrawn for consumption (and consequently recovered from ratepayers through the PGA). The withdrawal of recoverable cushion gas occurs after the gas utility has made the decision to abandon the storage field, hence the description "recoverable cushion gas."

The cost of non-recoverable cushion gas (Account 352.3, Nonrecoverable Natural Gas) is transferred from storage to plant in service (Account 101, Gas Plant in Service) and recovered through Nicor's base rates (as was done in Nicor's1995 rate case, Docket No. 95-0219).[5] Underground storage expenses are also to be recovered through a company's base rates. The cost of non-recoverable cushion gas and gas used by the utility in the operation of the

[4] See, Uniform System of Accounts for Gas Utilities Operating in Illinois.
[5] Northern Illinois Gas Company, Proposed General Increase in Rates for Gas Service, Ill. C.C. Docket No. 95-0219, Order Date April 3, 1996.

storage field are not recoverable through the PGA (these costs are recovered though base rates by a return on the amount included in plant in service in rate base, depreciation of plant balance, and an O&M expense allowance).

Q. During its1995 rate case, did Nicor reclassify any of its working gas and/or recoverable cushion gas inventory to non-recoverable cushion gas?

A. In Docket No. 95-0219, Nicor reclassified $21.199 million of working gas (28.255 Bcf) and $4.249 million of recoverable cushion gas (0.976 Bcf) to non-recoverable cushion gas (total of $25.448 million).[6] The reclassification to non-recoverable cushion gas increased Nicor's revenue requirement since the non-recoverable cushion gas is depreciated (unlike working gas and recoverable cushion gas) and included in rate base. Thus, Nicor has established the practice of adjusting its working gas inventory prior to a rate case.

Q. Has the 2% adjustment factor issue been addressed in other Commission proceedings?

[6] See, Part 285 Filing Requirements, Schedule B-2.2 and Data Responses IIEC 20 and POD 2.3.

A. Yes, this issue was addressed by Staff witness Dennis L. Anderson[7] and myself[8] in Docket No. 01-0707, the 2001 PGA reconciliation for Peoples Gas Light and Coke Company ("Peoples").

Q. How was the issue resolved in the 2001 Peoples PGA reconciliation?

A. In his rebuttal testimony, Peoples witness David Wear states "the Company will not oppose Staff's proposed disallowance ($4,628,267) associated with maintenance gas. Moreover the Company will account for maintenance gas in the manner described by Mr. Knepler."[9] That order was entered on March 28, 2006 and the maintenance gas issues were addressed in the "Accounting Proposals Adopted from the ALJPO" section at pages 8-9, Findings 8, 9 and 11. (Docket No. 01-0707)

SUMMARY OF PROPER STORAGE ACCOUNTING

Q. Would you summarize your position on the accounting for the 2% adjustment?

A. The PGA does not allow the cost of gas to be charged to customers until it is available for consumption. This is precisely why the cost of purchased gas that is injected into storage is deducted from gas costs and charged to storage inventory (i.e., reclassified from gas costs to storage inventory). The cost of the

[7] ICC Staff Exhibit 2.00, Direct Testimony of Dennis L. Anderson, pp. 47-53.
[8] ICC Staff Exhibit 1.00, Direct Testimony of Steven R. Knepler, pp. 14-28.
[9] Rebuttal Testimony of David Wear, Respondent's Exhibit F, Non-proprietary, at lines 1220-1228.

gas is held in an inventory account until it is withdrawn and delivered to the customer. The fact of the matter is that the gas represented by the 2% add on to actual withdrawals has never left the storage field. Any loss of this gas while in storage is the result of, and a cost associated with, the operation of a company owned storage field. As such, it is not a recoverable gas cost as defined by Section 525.40 of the Commission's PGA rule. Costs associated with the development, operation, and maintenance of company owned storage fields can only be recovered through a company's base rates. Thus Nicor's 2% accounting adjustment factor applied to Company owned aquifer storage withdrawals:

- **Violates Part 525, Purchased Gas Adjustment Clause (Docket No. 94-0403, Order Date August 23, 1995);**
- **Violates Part 505, the Uniform System of Accounts (USOA) for Gas Utilities Operating in Illinois (Docket No. 98-0586, Order Date January 13, 1999); and**
- **Is inconsistent with Nicor's practice of adjusting working gas inventory in its 1995 rate case (and approved by the Commission in Docket No. 95-0219, Order Date April 3, 1996).**

Summary of Conclusions and Recommendations

Q. In your November 2003 direct testimony you made 5 recommendations related to Nicor's accounting for the 2% gas lost in storage. What is the current status of those recommendations?

A. The recommendations made in my November 2003 direct testimony, and the current status of each recommendation (shown in *italic font*), are the following:

- Recommendation 1: I recommended that the Commission direct Nicor to cease the practice of applying an adjustment factor to the quantities of gas withdrawn from its aquifer storage fields.

  Current Status
  Adopted in the 2004 rate order. The Commission agreed with Staff and ordered Nicor to implement this recommendation:

  > **In sum Nicor has failed to meet its burden that continuing to recover 2% withdrawal factor from Sales customers through Rider 6, Gas Supply Cost, is just and reasonable. Staff's position is adopted in *toto*…and Nicor is directed to cease its current practice of recovering storage losses through Rider 6.** (Docket No. 04-0779, Order, September 20, 2005, p. 40)

- Recommendation 2: I recommended that the Commission disallow the cost of gas and order a refund related to the 2% adjustment factor that has been charged to ratepayers for the period 1999-2002. The amount of the refund related to the 2% adjustment factor has been reflected in the testimony and schedules of Staff witnesses Zuraski and Everson (ICC Staff Exhibit 1.0 and 3.0, respectively).

  Current Status
  I am maintaining Recommendation 2.

- Recommendation 3: I recommended that the Commission direct Nicor to account for the portion of gas injected into its storage fields in order to maintain pressure as credits from Account 164.1, Gas Stored Underground and as charges to Account 117, Gas Stored Underground (for the recoverable portion of cushion gas) or to Account 101, Gas Plant (for the nonrecoverable portion of cushion gas).

  Current Status
  Nicor agreed to adopt this recommendation in its 2008 rate order. (Docket No. 08-0363, Order, March 25, 2009, pp. 180-181) Thus, this recommendation is no longer necessary.

- Recommendation 4: I recommended that Nicor be ordered to submit its revised aquifer storage withdrawal accounting procedures and revised monthly storage injections and withdrawals reports to the Commission's Chief Clerk with a copy to the Manager of the Accounting Department within 30 days after the date a final order is entered in this proceeding.

<u>Current Status</u>
Nicor agreed to adopt this recommendation in its 2008 rate order. (Docket No. 08-0363, Order, March 25, 2009, pp. 180-181) Nicor has submitted revised accounting procedures in a letter dated June 29, 2009 with an effective date of July 1, 2009. Thus, this recommendation is no longer necessary.

- <u>Recommendation 5:</u> I recommended that Nicor perform an annual internal audit of its gas purchasing, storage injection and withdrawal activities and submit a copy of the audit report to the Manager of the Commission's Accounting Department by May 1 of each year after the date a final order is entered in this proceeding until May 1, 2008.

<u>Current Status</u>
I am maintaining Recommendation 5; however, because of the passage of time since the filing of my November 2003 direct testimony, the period for internal audit should be revised to the 5 succeeding years after an order is entered in this proceeding, i.e., assuming a final order is entered in 2010, until 2015.

In summary, I am maintaining my original Recommendations 2 and 5 (with Recommendation 5 being revised for the period to be covered by internal audits); Recommendations 1, 3, and 4 are no longer necessary as Nicor has already agreed to or has been ordered to adopt these procedures.

<u>CONCLUSION</u>

Q. Does this question end your prepared direct testimony on reopening?

A. Yes, it does.